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EMPLOYMENT AND UNEMPLOYMENT

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Officially, the unemployed are people who are registered as able, available and willing to work at the going wage rate but who cannot find work despite an active search for work.

For the Euro Zone as a whole the rate of unemployment has been persistently high in recent years – never lower than eight per cent and now rising to nearly nine per cent. Unemployment is a major economic, social and political problem in countries such as Poland, Germany, Spain and France – although the Spanish have succeeded in bringing their unemployment down from high levels over the last few years.

Now consider some of the main underlying causes of people being out of work.

Frictional unemployment is transitional unemployment due to people moving between jobs. For example, redundant workers or workers entering the labour market for the first time (such as university graduates) may take time to find appropriate jobs at wage rates they are prepared to accept. Many are unemployed for a short time whilst involved in job search. Imperfect information in the labour market may make frictional unemployment worse if the jobless are unaware of the available jobs.

Structural unemployment occurs when there is a long run decline in demand in an industry leading to a reduction in employment perhaps because of increasing international competition. Globalization is a fact of life – and inevitably it leads to changes in the patterns of trade between countries over time. Britain for example has probably now lost for good, its cost advantage in manufacturing goods such as motor cars, household goods and audio-visual equipment. Manufacturing industry has lost over 400,000 jobs in the last five years alone. Structural unemployment exists where there is a mismatch between skills of workers and the requirements of the new job opportunities. Many of the unemployed from manufacturing industry (e.g. in coal, steel and engineering) have found it difficult to find new work without an investment in re-training. This problem is one of occupational immobility of labour.

Cyclical unemployment is involuntary unemployment due to a lack of demand for goods and services. When there is a recession or a severe slowdown in economic growth, we see a rising unemployment because of plant closures, business failures and an increase in worker lay-offs and redundancies. A downturn in demand is often the stimulus for businesses to rationalize their operations by cutting employment in order to control costs and restore some of their lost profitability.

Real wage unemployment is considered to be the result of real wages being above their market clearing level leading to an excess supply of labour. Some economists believe that the minimum wage risks creating unemployment in industries where international competition from low-labour cost producers is severe. As yet, there is relatively little evidence that the minimum wage has created rising unemployment on the scale that was feared.

Hidden unemployment is when there are thousands of people who by any reasonable definition are unemployed, but who are not picked up by the official unemployment statistics. Many have become discouraged workers and have stopped actively searching for work.

High unemployment is widely recognized to create substantial costs for individuals and for the economy as a whole. Some of these costs are difficult to measure, especially the longer-term social costs of a high level of unemployment. Some of the costs are summarised below:

1. Loss of income. The majority of the unemployed experience a decline in their living standards and are worse off out of work.

2. Loss of national output. Unemployment involves a loss of potential national output (i.e. GDP operating below potential) and represents an inefficient use of scarce resources. If some people choose to leave the labour market permanently because they have lost the motivation to search for work, this can have a negative effect on long run aggregate supply (LRAS) and there by damage the economy's growth potential.

3. Fiscal costs. The government loses out because of a fall in tax revenues and higher spending on welfare payments for families with people out of work. The result can be an increase in the budget deficit which then increases the risk that the government will have to raise taxation or scale back plans for public spending on public and merit goods.

4. Social costs. Rising unemployment is linked to social deprivation. There is a relationship with crime, and social dislocation (increased divorce rates, worsening health and lower life expectancy).

Some countries are more successful than others in reducing the scale of unemployment. In general the most effective policies are those that:

1. Stimulate an improvement in the human capital of the workforce – so that more of the unemployed have the skills to take up the available jobs. Policies normally concentrate on improving the occupational mobility of labour. The pattern of employment in any modern economy is always changing, so people need to have sufficient flexibility to adapt to structural changes in industries over the years.

2. Improve incentives for people to search and then accept paid work – this may require reforms of the tax and benefits system, for example, a reduction in the starting rate of income tax (an incentive for people in lower paid jobs). Or perhaps a change in welfare benefits such that people who find work do not experience a sharp with drawal of benefits because they are now earning more. Targeted measures to improve incentives, including the linking of welfare benefits to participation in work experience programmes which is part of the New Deal programmeor lower tax rates for people on low incomes might have an impact.

3. Employment subsidies:Government subsidies for those firms that take on the long-term unemployed will create an incentive for businesses to increase the size of their workforce.

4. Achieve a sustained period of economic growth – this requires that aggregate demand is sufficiently high for businesses to be looking to expand their workforce. The Keynesian theory of unemployment emphasizes the argument that if monetary and fiscal policy does not keep demand at a high enough level, then the economy is less likely to be able to sustain a high rate of employment. However, not every increase in aggregate demand and production has to be met by employing more labour. Each year we expect to see a rise in labour productivity (more output per worker employed). And, businesses may decide to increase production by making greater use of capital inputs such as extra units of machinery. A growing economy creates jobs for people entering the labour market for the first time. And, it provides employment opportunities for people unemployed and looking for work.

Economists agree that unemployment cannot fall to zero since there will always be frictional unemployment caused by people moving into the labour market and others switching between jobs. Full-employment might be defined as when the labour market has reached a state of equilibrium - i.e. when those who are willing and able to work at going wage rates are able to find work. Another interpretation of full-employment is when the total of people out of work matches the number of unfilled job vacancies. The problem with this is that estimates of the scale of job vacancies very considerably.